

Report
of the
Examination of
Ettrick Mutual Insurance Company
Ettrick, Wisconsin
As of December 31, 2000

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 18, 2001

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of
December 31, 2000, of the affairs and financial condition of

Ettrick Mutual Insurance Company (EMIC)
Ettrick, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1996 as of December 31, 1995.
The current examination covered the intervening time period ending December 31, 2000, and
included a review of such subsequent transactions deemed essential to complete this
examination.

The Summary of Examination Results contains elaboration on all areas of the
company's operations. Special attention was given to the action taken by the company to satisfy
the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company in 1877,
under the provisions of the then existing Wisconsin Statutes. The original name of the company
was the Ettrick Scandinavian Mutual Insurance Company. Subsequent amendments to the
company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation to include LaCrosse County within the company's authorized territory. There were no amendments to the bylaws.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Trempealeau, Jackson, Buffalo, Eau Claire and LaCrosse

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. Farmowners and farm fire policies are the company's principal lines of coverage.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one month, three months, six months, or one year, with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 32 agents, one of whom is a director of the company. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
Property & Casualty	15%
Inland Marine	15%
Liability	15%

Most losses are adjusted by independent adjusters, who bill the company for their services. If a loss is adjusted by a director, the director receives \$ 0.31 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Robert H. Hanson	Farmer	Ettrick	2002
Roger Foss	Farmer	Ettrick	2003
DaLayne E. Rand	Manager	Ettrick	2001
Arthur L. Ofsdahl	Farmer	Ettrick	2003
John L. Sander	Oil Company Manager	Galesville	2001
Timothy Rand*	Independent Insurance Agent	Ettrick	2002

Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$45.00 for each meeting attended and \$0.38 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2001 Salary
Robert H. Hanson	President	\$ 2,040
Roger Foss	Vice President	100
DeLayne E. Rand	Secretary/Treasurer	\$26,400

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
Robert H. Hanson, Chair
Roger Foss
DeLayne Rand

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1996	\$352,307	\$116,224	1,268	\$139,060	\$920,724	\$649,200
1997	393,541	236,506	1,213	57,608	1,037,737	709,562
1998	454,624	334,054	1,257	(8,954)	1,008,296	702,133
1999	386,678	221,570	1,219	24,031	1,031,128	723,241
2000	305,670	249,952	1,234	(32,721)	1,040,139	664,459

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1996	\$596,102	\$434,165	\$649,200	91.8%	66.9%
1997	616,437	443,427	709,562	86.9	62.5
1998	607,784	410,166	702,133	86.6	58.4
1999	614,061	400,738	723,241	84.9	55.4
2000	596,843	364,586	664,459	89.8	54.9

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1996	\$116,224	\$132,092	\$352,307	33%	30%	63%
1997	236,506	142,172	393,541	60	32	92
1998	334,054	171,394	454,624	73	42	115
1999	221,570	175,924	386,678	57	44	101
2000	249,952	133,705	305,670	82	37	118

In the five years since the prior exam, gross premiums written have remained relatively stagnant, growing only 0.1% since 1996. During the same period, Net Premiums Written has declined by 16%, and Surplus has increased by 2.4%. The company reported underwriting losses in three of the last five years ('98 – '00). The 1998 underwriting loss was the result of heavy storm-related losses, and related loss adjusting expenses. The 1999 and 2000 underwriting losses were due largely to increasing reinsurance premiums. In addition, the

company had several high dollar value claims in 2000 that approached the company's individual occurrence of loss retention of \$75,000.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed that there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Grinnell Mutual Reinsurance Company
Effective date:	January 1, 1995, continuous
Termination provisions:	By either party, any January 1, with 90 days' advance written notice

The coverages provided under this treaty are summarized as follows:

- | | |
|----------------------|--|
| Type of contract: | Excess of Individual Occurrence of Loss |
| Lines reinsured: | All property risks |
| Company's retention: | \$75,000 |
| Coverage: | 100% up to \$500,000 on Livestock/Poultry/Horse Operations and Commercial/Public Property; 100% up to \$750,000 on Farm Outbuildings and Dwellings |
| Reinsurance premium: | \$ 0.1964 per \$1,000 Adjusted Gross Fire Risk In Force |
| Ceding commission: | None |
- | | |
|----------------------|--|
| Type of contract: | Aggregate Excess Reinsurance |
| Lines reinsured: | All property risks |
| Company's retention: | Annual attachment point, being the product of adjusted gross fire risks in force, the 10-year gross fire ratio, the individual occurrence of loss credit, and the load factor. The attachment point for 2001 is \$290,884. |
| Coverage: | 100% of losses above attachment point, up to \$500,000 on Livestock/Poultry/Horse Operations and Commercial/Public Property; and up to \$750,000 on Farm Outbuildings and Dwellings |
| Reinsurance premium: | \$ 0.6890 per \$1,000 Adjusted Gross Fire Risk In Force |
| Ceding commission: | None |
- | | |
|-------------------|---------------------------------------|
| Type of contract: | Facultative Reinsurance |
| Lines reinsured: | All property risks specifically ceded |

	Company's retention:	Individually determined
	Coverage:	Individually determined
	Reinsurance premium:	Individually determined
	Ceding commission:	None
4.	Type of contract:	Comprehensive Liability
	Lines reinsured:	All liability coverages written by the company
	Company's retention:	\$0
	Coverage:	100% of liability losses ceded
	Reinsurance premium:	100% of liability premiums ceded
	Ceding commission:	20% of liability premiums ceded

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2000. Adjustments made as a result of the examination are noted at the end of this section of this report in the area captioned "Reconciliation of Policyholders' Surplus."

Ettrick Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2000

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	\$ 23	\$	\$	\$ 23
Cash Deposited in Checking Account	46,173			46,173
Cash Deposited at Interest	260,920			260,920
Bonds (at Amortized Cost)	390,006			390,006
Stocks or Mutual Fund Investments (at Market)	155,277			155,277
Real Estate (Net of Accumulated Depreciation and Encumbrances)	4,380			4,380
Premiums and Agents' Balances In Course of Collection	5,349			5,349
Premiums and Agents' Balances and Installments Booked But Deferred and Not Yet Due	167,451			167,451
Investment Income Due or Accrued		8,107		8,107
Electronic Data Processing Equipment - Excluding Software (Cost Less Accumulated Depreciation	2,104			2,104
Fire Dues Recoverable	349			349
Furniture & Fixtures	<u>1,592</u>	<u> </u>	<u>1,592</u>	<u> </u>
TOTALS	<u>\$1,040,139</u>	<u>\$8,107</u>	<u>\$1,592</u>	<u>\$1,031,128</u>

Liabilities and Surplus

Net Unpaid Losses	\$ 13,350
Unpaid Loss Adjustment Expenses	268
Commissions Payable	32,998
Federal Income Taxes Payable	5,808
Net Unearned Premiums	302,401
Reinsurance Payable	17,132
Amounts Withheld for the Account of Others	787
Payroll Taxes Payable	520
Accounts Payable	825
Accrued Property Taxes	<u>1,591</u>
TOTAL LIABILITIES	375,680
Policyholders' Surplus	<u>664,459</u>
TOTAL	<u>\$1,040,139</u>

Ettrick Mutual Insurance Company
Statement of Operations
For the Year 2000

Net Premiums and Assessments Earned	<u>\$305,670</u>
Deduct:	
Net Losses Incurred	234,635
Net Loss Adjustment Expenses Incurred	15,317
Other Underwriting Expenses Incurred	<u>133,705</u>
Total Losses and Expenses Incurred	<u>383,657</u>
Net Underwriting Gain (Loss)	<u>(77,987)</u>
Net Investment Income:	
Net Investment Income Earned	51,630
Net Realized Capital Gains	<u>0</u>
Total Investment Income	<u>51,630</u>
Federal Income Taxes Incurred	<u>6,364</u>
Net Income (Loss)	<u>(\$32,731)</u>

Ettrick Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the 5-Year Period Ending December 31, 2000

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

Surplus as Regards policyholders, December 31, 1995		\$507,921
1996		
Net income (loss)	\$139,060	
Net unrealized capital gains or losses	1,682	
Change in nonadmitted assets	<u>537</u>	
Change in surplus as regards policyholders for the year		<u>141,279</u>
Surplus as regards policyholders, December 31, 1996		\$649,200
1997		
Net income (loss)	\$57,608	
Net unrealized capital gains or losses	2,696	
Change in nonadmitted assets	<u>58</u>	
Change in surplus as regards policyholders for the year		<u>60,362</u>
Surplus as regards policyholders, December 31, 1997		\$709,562
1998		
Net income (loss)	\$(8,954)	
Net unrealized capital gains or losses	1,133	
Change in nonadmitted assets	<u>392</u>	
Change in surplus as regards policyholders for the year		<u>(7,429)</u>
Surplus as regards policyholders, December 31, 1998		\$702,133
1999		
Net income (loss)	\$24,031	
Net unrealized capital gains or losses	(3,231)	
Change in nonadmitted assets	<u>308</u>	
Change in surplus as regards policyholders for the year		<u>21,108</u>
Surplus as regards policyholders, December 31, 1999		\$723,241

2000

Net income	\$(32,721)	
Net unrealized capital gains or losses	(25,554)	
Change in nonadmitted assets	<u>(507)</u>	
Change in surplus as regards policyholders for the year		<u>(58,782)</u>
Surplus as regards policyholders, December 31, 2000		<u>\$664,459</u>

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2000, Annual Statement	\$664,459
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Item	Increase	Decrease	
Unearned Premium	\$54,104		
Commissions Payable	7,875		
Unpaid Losses	7,384		
Deferred Installments		\$74,418	
Total	\$69,366	\$74,418	
Decrease to Surplus per Examination			(5,052)
Policyholders' Surplus per Examination			\$659,407

Reclassification Account	Debit	Credit	
Unearned Premiums	\$ 8,238		
Advance Premiums		\$ 8,238	
Total	\$ 8,238	\$ 8,238	

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Underwriting—It is recommended that the company take further steps to more adequately ensure that all policy applications are properly signed, as required by s. 612.52, Wis. Stat.

Action—Compliance

2. Underwriting—It is recommended that the company adopt a procedure whereby inspection reports are prepared for all inspections. It is further recommended that the company maintain a log of all completed inspections.

Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	\$ 65,000
Directors & Officers Liability	1,000,000
Business Owners Sure-all Policy:	
Business Liability:	500,000
Medical Expenses Per Person:	5,000
Fire Legal Liability:	50,000
Building	80,227
Business Personal Property	12,800
Money & Securities	10,000
Workers' Compensation/Employers Liability	
Bodily Injury by Accident (Per Accident):	100,000
Bodily Injury by Disease (Per Employee):	100,000
Bodily Injury by Disease (Policy Limit):	100,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection program in place. The inspection program concentrates on outdated, unkept, and low utilization buildings. As of 12/31/00, most of the risks had been inspected within the last 3 years, and it was determined that replication would not be practical for most of them. The company's current plan is to get inspections done on new risks as they come up, and do special cases as necessary.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2000.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computers is limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept on-site in a fire-proof safe. In addition, computer data is also backed-up weekly, and kept off-site in a fire-proof safe.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. The company's disaster recovery plan does not appear to be adequate: It does not include a contingency plan for the assignment of crucial duties in the event that certain key personnel are unable to perform them. It is suggested that the company develop a contingency plan for the assignment of crucial duties in the event that key personnel are unable to perform them.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The examiner noted that the company's investment advisor held several of the company's stocks and bonds at 12/31/00. The company had no formal written management agreement or custodial agreement with the advisor. The company has since signed a custodial agreement with a bank, and these investments are now in the custody of the bank. As the company is currently in compliance, no recommendation will be made.

Transition into the New Investment Rule

On January 1, 1996, the investment rule for town mutuals was amended to allow town mutuals to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$675,680
2. Liabilities plus 33% of gross premiums written	572,638
3. Liabilities plus 50% of net premiums written	557,973
4. Amount required (greater of 1, 2, or 3)	675,680
5. Amount of Type 1 investments as of 12/31/2000	<u>596,938</u>
6. Deficiency	<u>(78,742)</u>

The company did not have sufficient Type 1 Investments at 12/31/00. Since 12/31/00, the company sold one of its Type 1 Preferred Stocks with a statement value of \$22,950. In addition, review of the schedule of Type 1 Bonds (Schedule C, Section 1 – Part 1) revealed 3 bonds with NAIC ratings less than ‘1’ (Conseco, Hasbro, Inc., and Laidlaw, Inc.). Per the Town Mutual Annual Statement Instructions: “Type 1 bonds must have a final maturity of 15 years or less, and must have a rating of ‘BBB’ or better by Standard & Poor’s or Moody’s or have a rating of ‘1’ by the NAIC’s Valuation of Securities manual.” Accordingly, these bonds should have been reported on Schedule C, Section 1 – Part 2 (Type 2 Bonds). The Statement value of these 3 bonds was \$35,868 at 12/31/00. After adjusting the Type 1 Investment total for these changes, the company had a Type 1 Deficiency of \$137,560 as of the last date of fieldwork (5/18/01). It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

ASSETS

Cash and Invested Cash

\$307,116

The above asset is comprised of the following types of cash items at 12/31/00:

Cash in company's office	\$ 23
Cash deposited in banks-checking accounts	46,173
Cash deposited in banks at interest	<u>260,920</u>
Total	<u>\$307,116</u>

Cash in the company's office at year-end represents the company's petty cash fund.

A physical count was not made by the examiners during the course of the examination, as the company no longer uses a petty cash fund.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 10 certificates of deposit in 5 depositories. Deposits were verified by confirmation and by an actual inspection of certificates. Interest received during the year 2000 totaled \$15,061 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 2.53% to 7.00%. Accrued interest on cash deposits totaled \$844 at year-end.

Book Value of Bonds

\$390,006

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2000. At 12/31/00, the company's bonds were either held by the company's investment advisor, or held in the company's vault. As mentioned previously, the company has since signed a custodial agreement with a bank; bonds that were previously held by the company's investment advisor have been transferred to the company's custodial account with the bank.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. During the

examiner's review of this account, it was noted that the company listed 3 bonds on Schedule C, Section 1 – Part 1 (Type 1 Bonds) with NAIC ratings of less than '1'. These bonds included: Consecro (CUSIP #20846NAB1), Hasbro, Inc. (CUSIP #418056AK3), and Laidlaw, Inc. (CUSIP #50730KAM9). Per the Town Mutual Annual Statement Instructions: "Type 1 bonds must have a final maturity of 15 years or less and must have a rating of 'BBB' or better by Standard & Poor's or Moody's or have a rating of '1' by the NAIC's Valuation of Securities manual." It is recommended that in future Annual Statements, the company report bonds rated lower than 'BBB' or NAIC '1' on Schedule C, Section 1 – Part 2, in accordance with the Town Mutual Annual Statement Instructions.

Interest received during 2000 on bonds amounted to \$28,081 and was traced to cash receipts records. Accrued interest of \$6,064 at December 31, 2000, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments

\$155,277

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2000. Stocks owned by the company are located in the company's vault.

During a physical inspection of the company's stock certificates, it was noted that stock certificates for the NAMICO common and Wisconsin Reinsurance Class B preferred stocks could not be located. It is recommended that the company contact NAMICO and Wisconsin Reinsurance to obtain copies of the stock certificates that could not be located.

Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2000 on stocks and mutual funds amounted to \$11,350 and were traced to cash receipts records. Accrued dividends of \$1,199 at December 31, 2000, were checked and allowed as a nonledger asset.

Book Value of Real Estate**\$4,380**

The above amount represents the company's investment in real estate as of December 31, 2000. The company's real estate holdings consisted of an office building owned and occupied by the company.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums**\$98,382**

This balance consists of amounts due from agents or policyholders at December 31, 2000, that are not in excess of 90 days past due at year-end (Premiums in the Course of Collection), and installments that were booked and not yet due (Deferred Installments).

For Premiums in the Course of Collection, the examiner looked at each receivable, verifying the amount due, the policy effective dates, and the premium due date. The examiner also traced the subsequent receipt of the premium to the company's cash receipts records for January and February 2001. During this review, the examiner noted that the account contained several receivables that were over 90 days past due. The total amount of these receivables was not material; therefore, no adjustment was made. However, it is recommended that in future Annual Statements, the company properly non-admit the portion of Premiums in the Course of Collection which are greater than 90 days past due.

For Deferred Installments, the examiner reviewed the company's report supporting this balance. The examiner noted that this report contained installment premiums in the amount of \$53,403 for policies that had effective dates on or after 1/1/01. The examiner also noted that this balance included Gross Deferred Installments on Liability premiums in the amount of \$21,014 (even though the company included Net Deferred Installments on Liability premiums in its

Unearned Premiums balance). Accordingly, an adjustment was made to the Deferred Installment balance, decreasing the balance by the amount of premiums recorded prior to the effective date (\$53,403), and decreasing the balance by the difference between the gross and net deferred installments for the Liability premiums (\$21,014) for a total downward adjustment to Deferred Installments (as well as surplus) of \$74,417. It is recommended that:

- ❑ The company's balance for Booked but Deferred Premiums and Premiums in the Course of Collection include only policies with effective dates on or prior to the statement date.
- ❑ The company report Deferred Installments net of reinsurance payable on those installments.

The examiner then tested a sample from the remaining report for reasonableness. The examiner compared each policy in the sample against the in-force policy register for policy number, effective dates, mode of payment, and premium written. The examiner then recalculated the amount of deferred premium based on the information obtained, and compared the recalculated amounts to the deferred balances in the report. No exceptions were found during the testing.

Investment Income Due and Accrued

\$8,107

Interest due and accrued on the various assets of the company at

December 31, 2000, consists of the following:

Cash Deposited at Interest	\$ 844
Bonds	6,064
Stocks	<u>1,199</u>
Total	\$8,107

The examiner reviewed the company's cash receipts records for January through April, 2001, and totaled all investment income received in each month. The examiner concluded that the accruals at 12/31/00 were reasonable compared to the amounts actually received.

Electronic Data Processing Equipment**\$2,104**

This asset consists of computers and printers owned by the company at December 31, 2000. The examiner verified this asset by reviewing purchase documentation, and testing accumulated depreciation.

Fire Dues Recoverable**\$349**

This amount represents fire dues overpaid on 2000 business. The examiner verified this asset to filed tax returns. The amount will be applied against 2001 fire dues.

Equipment, Furniture & Supplies**\$1,592**

This asset consists of \$1,592 of furniture and non-EDP equipment owned by the company at December 31, 2000. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses

\$5,966

This liability represents losses incurred on or prior to December 31, 2000, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$14,250	\$9,193	\$5,507
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>900</u>	<u>3,227</u>	<u>2,327</u>
Net Unpaid Losses	<u>\$13,350</u>	<u>\$5,966</u>	<u>\$7,384</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2000. To the actual paid loss figures was added an estimated amount for those 2000 and prior losses remaining unpaid at the examination date. Testing of the 12/31/00 unpaid loss reserves revealed a favorable development of \$7,384. An examination adjustment was made reducing Unpaid Losses (and increasing Surplus) by \$7,384.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly; however, there were several instances noted where it was difficult to determine if claims were being paid promptly (as much of the documentation received in support of a claim was not date-stamped), and several instances were noted where a signed proof of loss was not obtained from the claimant (in one instance, the claim exceeded several thousand dollars). In addition, the examiner noted 1 instance in which the loss occurred outside of the policy effective dates, and 1 instance where the date of loss was not indicated in either the claims file or the loss register. It is recommended that:

- ❑ The company obtain a proof of loss signed by the claimant for all claims exceeding a specified dollar amount determined by the company.

- ❑ The company date-stamp documentation supporting losses claimed – as evidence that the company is responding to claims in a timely manner, in compliance with s Ins 6.11, Wis. Adm. Code.
- ❑ The company take action to ensure that all claims reported in the loss register include the loss incurred date, and that all claims information reported in the loss register agrees with information in the policyholder files (i.e. the loss incurred date falls within the effective dates of the policy).

In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained (with the exception noted above).
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed (with the exception noted above).

Unpaid Loss Adjustment Expenses

\$268

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2000, but which remained unpaid as of year-end. The company estimated this balance by taking 10% of 12/31/00 Accounts Payable.

The examiners' analysis of expenses paid in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated. However, the examiner noted that the methodology used by the company to estimate this liability bore no relationship to losses incurred. It is recommended that the company develop a methodology for estimating unpaid loss adjusting expenses that is based on incurred losses. For example, the company can take the average ratio of paid loss adjusting expenses to paid losses over the previous five years, and apply this ratio to unpaid losses at year-end, to come up with a reasonable estimate for unpaid loss adjustment expenses.

Unearned Premiums**\$240,056**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. The examiner was unable to rely on the company's reports in determining this balance. The data was found to include subsequent transactions as well as premiums for policies with effective dates in 2001 (in the amount of \$54,107). In addition, this balance included premiums received in advance of the policy effective date of \$8,238. Accordingly, an adjustment was made to the Unearned Premium balance, decreasing the balance by the amount of premiums recorded prior to the effective date (\$54,107), resulting in an upward adjustment to surplus of \$54,107. In addition, a reclassification of \$8,238 was made to reclassify premiums paid in advance of the policy effective dates to Advance Premiums. It is recommended that the company establish a proper cut-off for year-end transactions and run all reports as of December 31 of each year before processing any transactions from the subsequent year.

It was also noted during review of this account balance that the company did not report its Gross and Net Unearned Nonproperty (Liability) premiums on Schedule H-2. It is recommended that the company include Gross Unearned Liability Premiums (Line 5 – Col. 3), and Net Unearned Liability Premiums (Line 12 – Col. 3) on Schedule H-2 in future Annual Statements.

Reinsurance Payable**\$17,132**

This liability consists of amounts due to the company's reinsurer at December 31, 2000, relating to transactions that occurred on or prior to that date.

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Federal Income Taxes Payable**\$5,808**

This liability represents the balance payable at year-end for federal income taxes incurred prior to December 31, 2000.

The examiners reviewed the company's 2000 tax return and verified amounts paid to cash disbursement records to verify the accuracy of this liability.

Commissions Payable**\$25,123**

This liability represents commissions due to the agents based on Agents' Balances at 12/31/00. The company's balance for this liability included commissions payable on policies effective on or after 1/1/01 in the amount of \$7,875. Since Agents' Balances should only include policies with effective dates in the current year, this amount should not have been included. Accordingly, an adjustment was made to the Commissions Payable balance, decreasing the balance by \$7,875, and resulting in an upward adjustment to surplus of \$7,875. It is recommended that the company's liability for Commissions Payable include only commissions payable on policies with effective dates on or prior to the statement date.

Amounts Withheld for the Account of Others**\$787**

This liability represents employee payroll deductions in the possession of the company at December 31, 2000. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable**\$520**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2000, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable**\$825**

This liability represents the company's general accounts payable incurred prior to December 31, 2000, which had not been paid. The examiner verified this balance by tracing the detail to supporting invoices and cancelled checks, and by reviewing cash disbursements in January and February 2001, to ensure that all liabilities incurred prior to 1/1/01 were properly accrued at year-end.

Accrued Property Taxes**\$1,591**

This liability represents property taxes accrued at December 31, 2000 on Real Estate owned by the company. This balance was verified by reviewing the property tax bill, and tracing the liability to subsequent cash disbursement.

V. CONCLUSION

As of December 31, 2000, the company reported assets of \$1,040,139 and liabilities of \$375,680. As a result of this examination, certain adjustments were made to various asset and liabilities accounts, resulting in an exam adjustment decreasing Policyholders' Surplus by \$5,052, bringing Policyholders' Surplus to \$659,407.

In the five years since the prior examination, gross premiums written have remained relatively stagnant, growing only 0.1% since 1996. During the same period, Net Premiums Written has declined by 16%, and Surplus has increased by 2.4%. The company reported underwriting losses in three of the last five years ('98 – '00). The 1998 underwriting loss was the result of heavy storm-related losses, and related loss adjusting expenses. The 1999 and 2000 underwriting losses were due largely to increasing reinsurance premiums. In addition, the company had several high dollar value claims in 2000 that approached the company's individual occurrence of loss retention of \$75,000.

The company complied with all prior exam recommendations. The exam resulted in ten recommendations, and one suggestion, as summarized in the 'Summary of Comments and Recommendations' section of this report.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 18 - Disaster Recovery Plan—It is suggested that the company develop a contingency plan for the assignment of crucial duties in the event that key personnel are unable to perform them.
2. Page 20 - Invested Assets—It is recommended that the company make no additional Type 2 investments until the company meets the required amount of Type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.
3. Page 22 - Bonds—It is recommended that in future Annual Statements, the company report bonds rated lower than 'BBB' or NAIC '1' on Schedule C, Section 1 – Part 2, in accordance with the Town Mutual Annual Statement Instructions.
4. Page 22 - Stocks and Mutual Fund Investments—It is recommended that the company contact NAMICO and Wisconsin Reinsurance to obtain copies of the stock certificates that could not be located.
5. Page 23 - Agents' Balances—It is recommended that in future Annual Statements, the company properly non-admit the portion of Premiums in the Course of Collection which are greater than 90 days past due.
6. Page 24 - Agents' Balances—It is recommended that:
 - ❑ The company's balance for Booked but Deferred Premiums and Premiums in the Course of Collection include only policies with effective dates on or prior to the statement date.
 - ❑ The company report Deferred Installments net of reinsurance payable on those installments.
7. Page 26 - Claims Payments—It is recommended that:
 - ❑ The company obtain a proof of loss signed by the claimant for all claims exceeding a specified dollar amount determined by the company.
 - ❑ The company date-stamp documentation supporting losses claimed – as evidence that the company is responding to claims in a timely manner, in compliance with s Ins 6.11 Wis. Adm. Code.
 - ❑ The company take action to ensure that all claims reported in the loss register include the loss incurred date, and that all claims information reported in the Loss Register agrees with information in the policyholder files (i.e. the loss incurred date falls within the effective dates of the policy).
8. Page 27 - Unpaid Loss Adjustment Expenses – It is recommended that the company develop a methodology for estimating unpaid loss adjusting expenses that is based on incurred losses. For example, the company can take the average ratio of paid loss adjusting expenses to paid losses over the previous five years, and apply this ratio to unpaid losses at year-end, to come up with a reasonable estimate for unpaid loss adjustment expenses.

9. Page 28 - Unearned Premiums—It is recommended that the company establish a proper cut-off for year-end transactions and run all reports as of December 31 of each year before processing any transactions from the subsequent year.
10. Page 28 - Unearned Premiums—It is recommended that the company include Gross Unearned Liability Premiums (Line 5 – Col. 3), and Net Unearned Liability Premiums (Line 12 – Col. 3) on Schedule H-2 in future Annual Statements.
11. Page 29 - Commission Payable—It is recommended that the company's liability for Commissions Payable include only commissions payable on policies with effective dates on or prior to the statement date.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Sarah Salmon of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Kristin Forsberg
Examiner-in-Charge